UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

101 FERC ¶ 61,294

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

Hackberry LNG Terminal, L.L.C. Docket Nos. CP02-374-000
CP02-376-000
CP02-377-000
CP02-378-000

PRELIMINARY DETERMINATION
ON NON-ENVIRONMENTAL ISSUES

(Issued December 18, 2002)

1. On May 30, 2002, Hackberry LNG Terminal, L.L.C. (Hackberry) filed an application, as supplemented,[1] under section 3 of the Natural Gas Act requesting authority to site, construct, and operate a liquefied natural gas (LNG) terminal near Hackberry, Louisiana. In addition, Hackberry requests authority under section 7(c) of the Natural Gas Act (1) to construct and operate a 35.4-mile long pipeline from Hackberry's proposed terminal to Transcontinental Gas Pipe Line Corporation's (Transco) compressor station in Beauregard Parish, Louisiana; (2) to provide open-access transportation and terminalling services under Subpart G of Part 284 of the Commission's regulations; and (3) to engage in certain activities and transactions under Subpart F of Part 157 of the regulations.

2. In this order, the Commission makes a preliminary determination that Hackberry's proposals, subject to the conditions discussed herein, are in the public interest. While our findings here support issuance of Hackberry's requested authorizations, this order does not consider or evaluate any of the environmental issues in this proceeding. These issues are still pending and will be addressed in a subsequent order when the environmental review and analysis are complete. Thus, final approval of Hackberry's proposals is dependent on a favorable environmental review and nothing in this order limits our actions regarding our environmental analysis.

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[1] Hackberry supplemented its application on June 24, 2002.

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3. Specifically, subject to subsequent evaluation of environmental issues, this order approves Hackberry's proposal under section 3 to construct and operate its LNG import terminal. This order also grants Hackberry authority to provide terminalling service to Dynegy Marketing & Trade (Dynegy Marketing) at the rates, terms, and conditions agreed to by these parties, but does not require Hackberry to offer open-access service or maintain a tariff or rate schedule for its terminalling service. Finally, this order approves Hackberry's proposal under section 7(c) to construct and operate a 35.4-mile long pipeline connecting the LNG terminal to the Transco's facilities; Hackberry's proposal to provide open-access transportation services on its pipeline under Part 284; and Hackberry's proposed initial rates, terms, and conditions of service for open-access transportation services, subject to the conditions described below. The order finds that the public interest will be served by allowing the introduction of new imported LNG to supplement natural gas supplies for our nation's natural gas markets at competitive prices.

I. Proposals

A. Facilities

4. In Docket No. CP02-378-000, Hackberry[2] proposes to construct an LNG terminal at the site of an existing liquid petroleum gas terminal near Hackberry, Louisiana.[3] Specifically, Hackberry proposes to construct and operate:

- an LNG unloading slip with two berths, each equipped with three unloading arms and one vapor return/delivery arm;

- three LNG storage tanks, each with a useable volume of 1,006,000 barrels or 10.4 Bcf;

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[2]Hackberry is a wholly owned subsidiary of Dynegy Midstream Services, Limited Partnership (Dynegy Midstream Services).

[3]Dynegy Midstream Services leases the site of the liquid petroleum gas terminal from the Lake Charles Harbor and Terminal District (District). The District is a political subdivision of the State of Louisiana that has jurisdiction over facilities in and around the Port of Lake Charles, the 34 inland miles of the Calcasieu Ship Channel, and the 36-mile portion of the Ship Channel extending outward from the mouth of the Calcasieu River into the Gulf of Mexico. Hackberry's proposed facilities are on District-owned land and the tankers to supply Hackberry's terminal will need to move through the Calcasieu Ship Channel.

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- nine intake pumps, each sized for 250,000 Mcf per day;

- ten second stage pumps, each sized for 188,000 Mcf per day;

- twelve submerged combustion vaporizers, each sized for 150,000 Mcf per day;

- a boil-off gas compressor and condensing system;

- an LNG circulation system to maintain the facilities at the appropriate temperature when LNG tankers are not being unloaded;

- a natural gas liquids recovery unit; and

- utilities, buildings, and service facilities.[4]

5. Hackberry states that the proposed LNG terminal will be capable of unloading approximately 210 LNG tankers per year. Hackberry states that the LNG in the ships will be pumped into the LNG storage tanks and later pumped from the storage tanks, vaporized, compressed up to pipeline pressure, and sent out from the terminal at a rate of up to 1,500,000 Dth per day. Hackberry states that, in some instances, the Btu content of the gas may be higher than that acceptable by downstream pipelines. In that event, Hackberry asserts that the LNG will be processed in a natural gas recovery unit to reduce the Btu content.

6. In Docket No. CP02-374-000, Hackberry proposes to construct and operate a 35.4-mile long, 36-inch diameter pipeline from the tailgate of the LNG terminal to Transco's compressor station in Beauregard Parish, Louisiana. The proposed route crosses Sabine Pipeline Company's, Florida Gas Transmission Company's, Tennessee Gas Pipeline Company's, and Texas Eastern Pipeline Company's existing pipelines. The proposed pipeline follows existing pipeline rights-of-way for 3.9 miles, an electric transmission right-of-way for 6.6 miles, and an abandoned/reclaimed water supply canal right-of-way for 2.8 miles.

[4]Hackberry states that it will remove all equipment, associated piping and foundations, an electrical substation, and buildings from the existing liquid petroleum gas terminal. Hackberry also plans to remove the existing dock.

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B. Open Season

7. Hackberry held an open season from December 21, 2001 until March 15, 2002. In its bid solicitation, Hackberry contends that it invited prospective customers to submit market based bids for the LNG terminalling services; stated that it would award capacity to no more than three qualified bidders in order to minimize operational difficulties unique to LNG import operations; and stated that the winning bidders would be selected by determining the bid, or combination of bids, and allocation of capacity that maximized net present value.

8. As a result of the open season, Hackberry states that it entered into a 30-year binding precedent agreement with Dynegy Marketing, an affiliate, for 100 percent of the proposed LNG terminalling capacity. Hackberry states that Dynegy Marketing submitted a bid with the highest net present value. Hackberry notes that Dynegy Marketing will be responsible for obtaining LNG supplies, arranging for the delivery of the supplies to Hackberry's terminal, and receiving authorization from the Department of Energy to import LNG into the United States.

C. Services and Rates

1. Services

9. In Docket No. CP02-376-000, Hackberry requests a blanket certificate under Subpart G of Part 284 of the regulations in order to provide firm and interruptible terminal service under Rate Schedules LNG-1 and LNG-2, respectively, and firm and interruptible transportation service of vaporized LNG and natural gas along its proposed pipeline under Rate Schedules FTS and ITS, respectively.

10. In order to deliver vaporized LNG from the terminal to downstream pipelines, Hackberry states that Rate Schedule LNG-1 and LNG-2 customers will be allocated a maximum daily transportation quantity under Rate Schedules FTS and ITS, respectively, that will equal the terminal customer's maximum daily delivery quantity. Hackberry asserts that capacity can also be used by the customer to receive gas from a pipeline for delivery to another interconnected pipeline and that capacity that is not allocated to LNG terminal service will be made available on an open-access basis to any prospective customer seeking transportation on Hackberry's pipeline.

11. In its application, Hackberry submitted a pro forma FERC Gas Tariff that provides for firm and interruptible terminal service under Rate Schedules LNG-1 and

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LNG-2, respectively, and firm and interruptible transportation service under Rate Schedules FTS and ITS, respectively.

12. Hackberry requests that the Commission waive the reporting requirement in section 157.6(b)(8), the filing requirements in Exhibit K (Cost of Facilities), Exhibit L (Financing), Exhibit N (Revenues, Expenses, and Income), and Exhibit O (Depreciation and Depletion) with respect to the LNG terminal, the accounting and reporting requirements in Part 201 and section 260.3 (Form 2A) of the regulations, and section 284.7(e). Hackberry also requests "any waivers that may be necessary to provide service under the terms and conditions stated in its pro forma tariff and/or a determination that such terms and conditions constitute reasonable operational conditions pursuant to 18 C.F.R. § 284.7(c)."

2. Rates

13. Hackberry requests market based rates for its LNG terminalling services under Part 284 of the regulations and the Commission's Alternative Rate Policy Statement.[5] To support its request for market based rates, Hackberry submitted a market power analysis assuming three different product markets: (1) field gas supply; (2) production-area storage; and (3) LNG terminalling service.[6] Under each scenario, Hackberry concludes that the markets are competitive and that its proposals meet the Commission's criteria for market based rates.

14. Hackberry proposes to charge cost-of-service rates designed under the straight-fixed-variable (SFV) design methodology for its firm and interruptible transportation services under Rate Schedules FTS and ITS, respectively. Hackberry estimates that the pipeline plant investment will be $70,261,999.[7]

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[5]Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines and Regulation of Negotiated Transportation Services of Natural Gas Pipelines (Alternative Rate Policy Statement), 74 FERC ¶ 61,076 (1996); reh'g and clarification denied, 75 FERC ¶ 61,024 (1996), reh'g denied, 75 FERC ¶ 61,066 (1996); petition for review denied, Burlington Resources Oil & Gas Co. v. FERC, Case No. 96-1160, et al. (D.C. Cir. July 20, 1998).

[6]See Hackberry's application at 13-17 and Exhibit Z .

[7]See Hackberry's November 13, 2002 filing in response to a data request.

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D. Part 157 Subpart F Blanket Certificate

15. In Docket No. CP02-377-000, Hackberry requests authority for a blanket certificate under Subpart F of Part 157 of the regulations in order to undertake certain routine construction, maintenance, and operational activities related to its proposed pipeline.

E. Justification for Proposals

16. Hackberry contends that the importation of LNG at its proposed terminal will provide new, competitively priced gas supplies that will help meet growing demands for gas in the United States. Hackberry asserts that its proposals will not rely on any subsidization from existing customers because it does not have any existing customers, that it will assume the economic risk associated with the project under its market-based rate proposals, that there will be no significant impact on landowners, and that there will be no adverse impact on existing pipelines and their customers.

II. Interventions

17. Notice of Hackberry's application was published in the Federal Register on July 2, 2002 (67 Fed. Reg. 44,436). The parties listed in the appendix to this order filed timely, unopposed motions to intervene. Timely, unopposed motions to intervene are granted by operation of Rule 214.

18. El Paso Merchant Energy, L.P. and BP Energy Company (BP Energy) filed untimely motions to intervene. El Paso Merchant's and BP Energy's untimely motions have demonstrated an interest in this proceeding and have shown good cause for seeking to intervene out of time. Further, the untimely motions will not delay, disrupt, or otherwise prejudice this proceeding. Thus, we will grant El Paso Merchant's and BP Energy's untimely motions to intervene.

19. Conoco Inc. and CITGO Petroleum Corporation filed a joint protest to Hackberry's application. Hackberry filed answers to Conoco's and CITGO's protest. Answers to protests are not permitted under our rules.[8] Nevertheless, we will accept Hackberry's answer in order to have a more complete record in this proceeding.

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[8] 18 C.F.R. § 385.213(a)(2) (2002).

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III. Discussion

A. Hackberry's Proposed LNG Terminal

1. Section 3 Finding

20. Since the proposed LNG terminal facilities will be used to import gas from a foreign country, the construction and operation of the facilities and site of their location require approval by the Commission under section 3 of the Natural Gas Act.[9] The Commission's authority over facilities constructed and operated under section 3 includes the authority to apply terms and conditions as necessary and appropriate to ensure that the proposed construction and siting is in the public interest.[10] Until now, the Commission has not had occasion to consider what criteria should apply to a project where one part (the pipeline) is built part under section 7(c) and another (the LNG terminal) under section 3. Section 3 provides that the Commission "shall issue such order on application . . . ." unless it finds that the proposal "will not be consistent with the public interest."

21. The record in this case shows that the Hackberry terminal will provide additional supplies of gas to natural gas customers. Further, Hackberry is a new entrant to the LNG business in the United States. It has no existing customers who might be adversely affected by the costs or risks of recovery of those costs of the proposed LNG terminal project. The economic risks will be borne fully by Hackberry. Thus, we find that, subject to the outcome of the pending environmental review, Hackberry's LNG terminal will not be inconsistent with the public interest and should be preliminarily approved.

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[9] The regulatory functions of section 3 of the Natural Gas Act were transferred to the Secretary of Energy in 1977 pursuant section 301(b) of the Department of Energy Organization Act (Pub. L. No. 95-91, 42 U.S.C. § 7101 et seq). In reference to regulating the imports or exports of natural gas, the Secretary subsequently delegated to the Commission the authority to approve or disapprove the construction and operation of particular facilities, the site at which such facilities shall be located, and with respect to natural gas that involves the construction of new domestic facilities, the place of entry for imports or exit for exports. DOE Delegation Order No. 00-004.00, 67 Fed. Reg. 8,946 (2002). Accordingly, applications for authority to import natural gas must be submitted to the Department of Energy. The Commission does not authorize imports.

[10] Distrigas Corporation v. FPC, 495 F.2d 1057, 1063-64 (D.C. Cir. 1974), cert. denied, 419 U.S. 834 (1974); Dynegy LNG Production Terminal, L.P., 97 FERC ¶ 61,231 (2001).

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22. As described above, Hackberry has proposed to provide LNG terminalling service under the terms and conditions of a pro forma tariff and proposed Rate Schedules LNG-1 and LNG-2. For the reasons discussed below, we believe that a change in policy is warranted and that a different form of regulation will better serve the public interest than the traditional open-access approach that we have applied previously to LNG import facilities. Specifically, we will grant Hackberry authority to provide LNG terminalling services to Dynegy Marketing at the rates, terms, and conditions mutually agreed to by these parties, subject to the condition that Hackberry file its contract with its affiliated customer prior to the commencement of construction of the LNG terminal facility. However, we will not require Hackberry to offer open-access service or maintain a tariff and rate schedules for its terminalling service. Our decision to adopt a less intrusive degree of regulation here does not affect our jurisdiction in this case. Section 3 of the Natural Gas Act reserves for the Commission the ability to "make such supplemental order in the premises as it may find necessary or appropriate." We will use such authority in the future if we receive complaints of undue discrimination or other anti-competitive behavior.

23. Our decision to adopt a new policy for LNG import facilities reflects consideration of several factors. First, we note that the prices, terms, and conditions of service for first sales of natural gas, including sales of imported LNG, have been deregulated by statute.[11] The sale of natural gas from these facilities would occur at, or downstream of, the tailgate of the LNG plant, where re-vaporized LNG would be delivered to Hackberry's pipeline.[12] These sales of natural gas would be made in competition with other sales of natural gas produced in the Gulf Coast region in a deregulated competitive commodity market. The terminal's costs would be part of the costs of producing and delivering LNG to the Gulf Coast natural gas marketplace, and would be recovered only through the sales of natural gas in these or downstream markets. This approach may provide incentives to develop additional energy infrastructure to increase much-needed supply into the United States, while at the same time ensuring competitive commodity prices and an open-access interstate pipeline grid. Given these facts, and because the entire risk of the project will be borne by Hackberry, there is no regulatory need to require a tariff and rate schedule as a condition of approving the LNG terminal under section 3.

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[11] See Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (1992).

[12] Hackberry's pipeline's rates, terms, and conditions of service would be provided under open-access authority.

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24. Our conclusion herein is further supported by comments made on the record at the recent public conference on policy issues facing the natural gas industry today. At the conference, representatives of the LNG industry argued that the Commission's open access requirements were having the unintended effect of potentially deterring investment in new LNG facilities in the United States. Participants in the conference argued that investors in a "full-supply-chain" LNG project needed the assured access to terminal capacity that could not occur under open-season bidding and timing and that many foreign governments would not approve LNG export projects without clear and certain access to markets.[13] No one at the conference or in subsequent comments challenged this view.

25. We also note that Congress recently amended the Deepwater Port Act to transfer to the Department of Transportation regulatory authority over LNG facilities constructed offshore in federal waters.[14] Section 106(d) of the Maritime Transportation Security Act specifically provides that the licensee of a deepwater port for natural gas (including LNG) may have exclusive use of the entire capacity of the deepwater port or facility for its own purposes, without being subject to the requirements of open access or common carriage.[15] Our decision in this case relies on our discretionary authority under section 3 of the Natural Gas Act to apply a similar approach to onshore LNG facilities. We believe that a similar approach is warranted here because Hackberry is a new entrant solely bearing the risk of the project's success in introducing new imported LNG supplies into the Gulf Coast natural gas supply markets. No captive customers bear any of the costs or risks of cost recovery and the recovery of the fixed costs of LNG terminalling can be accomplished only through the sales of LNG at competitive market prices. In addition, onshore LNG facilities should be at competitive parity with offshore facilities.

26. By adopting this approach, we retain our primary regulatory focus on the protection of customers of the wholesale natural gas market within the United States. The public interest is served through encouraging gas-on-gas competition by introducing new imported supplies of natural gas which will be accessible to all willing purchasers.

27. Finally, in their protests, BP Energy, Conoco, and CITGO argue that Hackberry will exercise market power through its LNG terminalling service and should not be

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[13]Comments of Global LNG and BP Energy Company, Natural Gas Markets Conference, Docket No. PL02-9-000 (October 25, 2002).

[14]Maritime Transportation Security Act of 2002, Pub. L. No. 107-295.

[15]Id., amending 33 U.S.C. § 1507.

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allowed to offer that service at market based rates. We disagree with a basic premise of this analysis, which would require us to offer cost-based rate protection to the international LNG trade. Our primary regulatory focus is the protection of the wholesale gas marketplace in the United States. For the reasons explained above, we believe that this purpose can best be achieved by allowing Hackberry to serve its affiliate at market rates while making the ultimate sale to customers on essentially the same basis as other first sellers of production-area gas supplies.

2. **Shipping Concerns**

28. Conoco and CITGO contend that Hackberry's proposals fail to address the adverse impacts from increased ship traffic in the Calcasieu Ship Channel, since the tankers to supply Hackberry's terminal will need to move through the Ship Channel. Conoco and CITGO believe that there will be serious and costly interruptions to the current marine users of the Calcasieu Ship Channel and, in support, cite interventions in Docket No. CP02-60-000, which involved CMS Trunkline LNG Company's proposal to expand an existing LNG terminal on the Calcasieu Ship Channel.[16]

29. Conoco and CITGO suggest "one or more" of the following procedures to provide sufficient evidentiary support for a reasoned decision in this proceeding: (1) "detailed discovery" to find more information; (2) a technical conference that interested parties and experts could attend; and (3) consolidation of this proceeding with CMS Trunkline's proceeding in Docket No. CP02-60-000.

30. The increased ship traffic caused by Hackberry's proposals are relevant to our review of this project under the National Environmental Policy Act of 1969 (NEPA).[17] The concerns about increased ship traffic are not a part of our review in a preliminary determination. Thus, we will examine the issues raised by Conoco and CITGO in a final order that evaluates the environmental issues in this proceeding.[18]

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[16]CMS Trunkline LNG Company, 100 FERC ¶ 61,217 (2002).

[17]42 U.S.C. § 4321 et seq.

[18]Like Conoco and CITGO, the District initially filed comments, contending that the increase in LNG tanker traffic caused by Hackberry's application could not be accommodated under the current operational conditions in the Calcasieu Ship Channel without a complete overhaul of operations at the Port of Lake Charles or a costly expansion of the Ship Channel's infrastructure. On November 12, 2002, the District filed (continued...)

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31. We will deny Conoco's and CITGO's requests for a technical conference, discovery, and consolidation. Our NEPA process will address the issues raised by Conoco and CITGO. In the NEPA process, Conoco and CITGO will have ample opportunity through scoping meetings and the filing of comments to the draft and final environmental impacts statements to raise concerns about the increased ship traffic in the Calcasieu Ship Channel.

3. **Waivers**

32. Hackberry requests waiver of the requirement in section 157.6(b)(8) that it provide detailed cost of service information about the capital and operating costs of the LNG terminal. Hackberry also requests waiver of the filing requirements in Exhibit K (Cost of Facilities), Exhibit L (Financing), Exhibit N (Revenues, Expenses, and Income), and Exhibit O (Depreciation and Depletion) with respect to the LNG terminal.

33. Hackberry requests waivers of the requirements in section 284.7(e) to charge reservation fees that collect all fixed costs under a straight fixed variable rate design methodology. Hackberry requests any waivers that may be necessary to provide service under the terms and conditions stated in its pro forma tariff and/or a determination that such terms and conditions constitute reasonable operational conditions under section 284.7(c). Finally, Hackberry LNG requests the Commission grant any other waivers that the Commission may deem necessary.

34. Since Hackberry will provide LNG terminal service to Dynegy Marketing under market based rates and we are authorizing terminal service under section 3 at rates, terms, and conditions mutually agreeable to the parties, we will not require Hackberry to follow the requirements of sections 157.6(b)(8), 157.14, and 284.7(e), with respect to its proposed LNG import facility and service.[19]

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[18](...continued)
a pleading stating that it had reached an agreement with Hackberry, resolving the concerns it had raised in its comments. In its pleading, the District states that Hackberry will pay "wharfage fees" that will contribute to infrastructure improvements necessary to accommodate increased LNG vessel traffic.

[19]Seneca Lake Storage, Inc., 98 FERC ¶ 61,163 (2002); Egan Hub Partners, L.P., 95 FERC ¶ 61,395 (2001); Central New York Oil and Gas Company, L.L.C., 94 FERC ¶ 61,194 (2001); Petal Gas Storage, L.L.C., 92 FERC ¶ 61,220 (2000), 90 FERC 61,243 (2000).

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B. Hackberry's Proposed Pipeline

35. Since the proposed pipeline facilities will be used to transport natural gas in interstate commerce subject to the jurisdiction of the Commission, the construction and operation of the facilities is subject to the requirements of subsections (c) and (e) of section 7 of the Natural Gas Act.

1. The Certificate Policy Statement

36. The Certificate Policy Statement provides guidance as to how we will evaluate proposals for certificating new construction.[20] The Certificate Policy Statement established criteria for determining whether there is a need for a proposed project and whether the proposed project will serve the public interest. The Certificate Policy Statement explained that in deciding whether to authorize the construction of major new pipeline facilities, we balance the public benefits against the potential adverse consequences. Our goal is to give appropriate consideration to the enhancement of competitive transportation alternatives, the possibility of overbuilding, subsidization by existing customers, the applicant's responsibility for unsubscribed capacity, the avoidance of unnecessary disruptions of the environment, and the unneeded exercise of eminent domain in evaluating new pipeline construction.

37. Under this policy, the threshold requirement for pipelines proposing new projects is that the pipeline must be prepared to financially support the project without relying on subsidization from its existing customers. The next step is to determine whether the applicant has made efforts to eliminate or minimize any adverse effects the project might have on the applicant's existing customers, existing pipelines in the market and their captive customers, or landowners and communities affected by the route of the new pipeline. If residual adverse effects on these interest groups are identified after efforts have been made to minimize them, we will evaluate the project by balancing the evidence of public benefits to be achieved against the residual adverse effects. This is essentially an economic test. Only when the benefits outweigh the adverse effects on economic interests will we proceed to complete the environmental analysis where other interests are considered.

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[20]Certification of New Interstate Natural Gas Pipeline Facilities (Certificate Policy Statement), 88 FERC ¶ 61,227 (1999), order clarifying statement of policy, 90 FERC ¶ 61,128, order further clarifying statement of policy, 92 FERC ¶ 61,094 (2000).

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38. The threshold requirement is that the pipeline must be prepared to financially support the project without relying on subsidization from its existing customers. Since Hackberry is a new pipeline company with no existing customers, the threshold requirement of no subsidization is not applicable here. Thus, we find that there is no risk of subsidization for the proposed pipeline.[21]

39. Also, there will not be any negative impact on existing services since Hackberry has no current customers. In addition, there will be no adverse impact on any other existing pipeline company or its customers because approval of Hackberry's proposals will not result in any unsubscribed capacity on existing pipelines in the area.

40. Under section 7(h) of the Natural Gas Act, an applicant with a Commission-issued certificate has the right to exercise eminent domain to acquire the land necessary to construct and operate its proposed facilities when it cannot reach a voluntary agreement with the landowner. Landowners whose land may be condemned have an interest in the applicant's proposals, as does the community near the right-of-way.[22] In our consideration of landowner and community interests under the Certificate Policy Statement, we seek to avoid unnecessary construction in order to minimize the applicant's power to condemn land to construct facilities under eminent domain rights conveyed by the Commission's certificate.[23]

41. Here, 13.3 miles of the 35.4-mile long pipeline will be constructed along existing rights-of-way. Hackberry contends that it has identified and contacted all nearby landowners to advise them of the proposals and has entered into discussions to obtain survey permission, as well as potential rights-of-way, along the proposed pipeline route. Thus, we find that there will be little or no impact on landowners and communities.

42. Hackberry must construct its pipeline without subsidies, since it has no existing customers. Further, Hackberry's proposed pipeline will provide public benefits without significant adverse economic impacts on existing pipelines and their customers or on landowners and the surrounding communities. Thus, this order makes a preliminary determination, pending completion of the environmental review, that Hackberry's proposal to construct and operate a 35.4-mile long pipeline from the LNG terminal to an interconnect with Transco are in the public convenience and necessity under section 7(c).

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[21] Southern Natural Gas Company, 99 FERC ¶ 61,345 (2002).

[22] Certificate Policy Statement, 88 FERC at p. 61,748.

[23] Id. See also, Order Clarifying Statement of Policy, 90 FERC at p. 61,398.

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2. Accounting Matters

a. Asset Retirement Obligation Costs

43. Hackberry's revised Exhibit K shows an estimated capitalized asset retirement obligation of $145,382 for the proposed pipeline.[24] Hackberry plans to record the asset retirement obligation amount in its accounts by debiting Account 372, Asset Retirement Costs - Transmission Plant, and crediting Account 230, Asset Retirement Obligations.[25] Hackberry plans to depreciate the plant asset amount over the planned 30-year depreciation life of the pipeline and accrete the asset retirement obligation by debiting Account 411.1, Accretion Expense, and crediting Account 230 at a credit adjusted risk-free rate of 13.25 percent.[26]

44. Hackberry alleges that its proposed accounting for asset retirement costs is based, in part, on proposals contained in a recent Notice of Proposed Rulemaking (NOPR) addressing the accounting, financial reporting, and rate filing requirements for asset retirement obligations.[27] Hackberry's proposed accounting, however, relies on speculative assumptions and does not comport in all respects with the rule changes contemplated in the NOPR. For instance, the proposed rule applies only to legal obligations for removal or dismantlement of assets. Nevertheless, Hackberry contends that it "does not know the exact agreements that it will enter into that would warrant the recording of an [asset retirement obligation]."[28] In addition, Hackberry used its proposed 13.25 percent return on equity to discount and accrete its asset retirement obligation. The proposed rule, however, requires the use of a credit adjusted risk-free rate, which likely is substantially lower than Hackberry's equity rate of return. Finally, deliberations in Docket No. RM02-7-000 are ongoing and we believe that action here would be premature.

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[24] See Hackberry's November 13, 2002 response to staff's data request.

[25] Id. at Question No. 3-C.

[26] See Hackberry's November 13, 2002 response to staff's data request, Question No. 3-C.

[27] Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations, Docket No. RM02-7-000, 101 FERC ¶ 61,102 (2002).

[28] See Hackberry's November 13, 2002 response to staff's data request, Question No. 3.

45. Thus, we will not approve Hackberry's recognition and measurement of an asset retirement obligation related to the proposed facilities at this time. If and when the recognition criteria for an asset retirement obligation are met, Hackberry shall conform its accounting to the Commission's accounting requirements then in effect for asset retirement obligations.

b. Income Taxes on Equity Allowance for Funds Used During Construction (AFUDC)

46. Hackberry includes an income tax gross-up on the equity component of AFUDC as part the AFUDC amount[29] for the proposed pipeline and classifies the projected $734,963 as plant in service on the pro forma balance sheet.[30] This classification is not consistent with our accounting instructions, which state that:

> An entity shall record the deferred tax liability for the equity component of AFUDC in Account 282, Accumulated Deferred Income Taxes - Other Property, and any corresponding regulatory asset in Account 182.3, Other Regulatory Assets . . . . This accounting shall be followed for the adjustments required upon initial application of the statement [Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes] and for all amounts of equity AFUDC capitalized in subsequent periods.[31]

47. Thus, we will require Hackberry to record its regulatory asset related to income taxes on the equity component of its AFUDC as a regulatory asset in Account 182.3, consistent with Commission guidance.

3. Cost of Service Rates for Pipeline Services

a. Hackberry's Proposals

48. For the 35.4-mile pipeline, Hackberry proposes to offer both firm (Rate Schedule FTS) and interruptible (Rate Schedule ITS) open-access transportation on a non-discriminatory basis under Part 284. The proposed maximum cost-based FTS reservation

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[29]Id. at Question No. 2.

[30]Hackberry's November 13, 2002 filing, Revised Exhibit L-4.

[31]AI93-5-000, Accounting for Income Taxes, dated April 23, 1993.

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rate is $0.7087 per Dth. Hackberry has not identified any variable costs, so the maximum and minimum FTS commodity rates are $0. The proposed maximum ITS commodity rate is $0.0233 per Dth. The proposed ITS and FTS authorized overrun rates are designed to be equivalent to a 100 percent load factor derivative of the maximum FTS cost-based rate and are to be charged based on usage. Hackberry estimates a fuel use and lost and unaccounted-for factor of 0.25 percent for FTS and ITS service.

49. Hackberry proposes a rate structure which reflects a SFV rate design with the rates derived using the proposed annual cost of service of $12,744,720[32] and annualized demand billing determinants of 547,500,000 Dth, based on design capacity of 1,500,000 Dth per day.

50. The proposed $12,744,720 annual cost of service is composed of: (1) operation and maintenance expenses of $1,415,000, based upon expected operations; (2) depreciation expenses of $2,339,725, using the proposed annual depreciation accrual rate of 3.33 percent applied to depreciable transmission plant; (3) amortization of debt financing costs of $163,069; (4) proposed accretion expenses of $19,263, related to the asset retirement obligation; (5) return allowance of $6,781,450, calculated from the proposed rate base and capitalization, including a 13.25 percent return on common equity, (6) federal and state income taxes of $1,821,213, using a 35 percent federal corporate income tax rate and a 8.0 percent State of Louisiana income tax rate; and (7) taxes other than federal and state income taxes of $205,000, all of which are ad valorem taxes.

51. Hackberry proposes a total rate base of $70,824,548, which is composed of gross plant investment of $70,261,999,[33] less $145,382 for the regulatory liability related to the FAS 143 asset retirement obligation, less $792,069 of deferred taxes related to AFUDC equity, plus $1,500,000 of cost to obtain debt financing. There is no depreciation reserve deducted from the rate base. The proposed capital structure is 70 percent debt and 30 percent equity, with 13.25 percent return on equity, an 8.0 percent interest cost, for an overall 9.58 percent after-tax rate of return.

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[32] In its November 13, 2002 filing, Hackberry provided an updated cost of service.

[33] Gross plant investment includes pipeline costs identified as $66,647,000, capitalized AFUDC on equity of $1,871,087, capitalized interest on debt of $1,598,530, and $145,382 for the Statement of Financial Accounting Standards (FAS) 143 asset retirement obligation.

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b. Commission Holding

52. We have reviewed the proposed cost of service, and generally find that it is reasonable for a new pipeline entity, such as Hackberry. However, we will discuss the following elements of the proposed cost of service.

1. Rate of Return

53. Hackberry, a Delaware limited liability company, is a direct, wholly-owned subsidiary of Dynegy Midstream Services. In turn, Dynegy Midstream Services is wholly owned by Dynegy, Inc. Hackberry does not have ownership in any other entity. Dynegy Midstream Services will furnish the equity capital for Hackberry.

54. Hackberry requests a 13.25 percent rate of return on equity in consideration of several factors (including financial leverage, capital market conditions, and project risks.) In SCG Pipeline, Inc.,[34] we found that SCG Pipeline's proposed 13.3 percent return on equity, based on a 60 percent debt to 40 percent equity ratio, fell within the zone of reasonableness derived using the discounted cash-flow methodology for regulated pipelines in the Horizon Pipeline Company proceeding,[35] and was lower than the 14 percent return on equity that we approved for other recently certificated pipelines with higher debt ratios.[36] Thus, we find that a 13.25 percent rate of return on common equity reasonable for a pipeline, such as Hackberry, with a 30 percent equity ratio.

2. Asset Retirement Obligation Costs

55. Hackberry proposed accounting and rate treatment for estimates of a FAS 143 asset retirement obligation. In the accounting matters described above, we declined to rule on the appropriateness of Hackberry's recognition and measurement of an asset retirement obligation related to the proposed facilities at this time. Thus, we will require Hackberry to eliminate all costs related to the asset retirement obligation from the calculation of rates.

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[34] 99 FERC ¶ 61,345 (2002).

[35] Horizon Pipeline Company, LLC, 92 FERC ¶ 61,205, at p. 61,687 (2000).

[36] See Islander East Pipeline Company, L.L.C., 97 FERC ¶ 61,363 (2001) and Millennium Pipeline Company, L.P., 97 FERC ¶ 61,292 (2001).

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3. Cost to Obtain Debt Financing

56. Hackberry proposes to include the $1,500,000 cost of obtaining debt financing as a separate rate-base item and amortize the debt financing costs over the 15-year life of the debt. Hackberry contends that this cost represents legal and other professional fees associated with obtaining the project-financed debt and does not consider debt discount.

57. Our review indicates that these are the types of costs that typically would be recoverable through rates as a part of the return of capital and are imbedded in the debt expense.[37] Although we are not precluding Hackberry from recovering costs that it demonstrates are properly accounted for and includible in its rates, we will, however, reject the separate rate base treatment of the $1,500,000 as not in accordance with our accounting definition.

4. Capitalized Equity AFUDC

58. Hackberry includes an estimated $734,963 of income taxes related to AFUDC equity gross-up. However, as described above, Hackberry improperly accounted for these amounts under the Commission's accounting procedures. We will require Hackberry to reflect the proper accounting treatment of equity AFUDC income tax gross-up in its rate calculation.

5. Depreciation and Amortization

59. Hackberry proposes a straight-line depreciation method that conforms with the Uniform System of Accounts. The life of the pipeline facilities is tied to the length of the long-term contract life for the LNG terminal facilities. Thus, the depreciation accrual for the pipeline over the life of the 30-year, long-term contract of the LNG terminal is reasonable. We will accept Hackberry's annual depreciation accrual rate of 3.33 percent for transmission plant.

60. Hackberry proposes to include a $163,069 amortization of debt financing costs as a separate item to the cost of service. We reject this cost of service amortization as a separate item for the same reason that we rejected the rate base treatment of the cost of debt financing.

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[37] See, Definition 11, Debt Expense, Uniform System of Accounts, 18 C.F.R. Part 201 (2002).

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61. By not including any accumulated depreciation in its rate base calculation, Hackberry has, in essence, proposed a day-one rate base to calculate its return allowance. Historically, our preferred methodology has been to use a first-year average in calculating the components of a pipeline's rate base.[38] Thus, we will direct Hackberry to revise its rate base calculation using the first-year average method.

6. Representative level for allocating costs to ITS service

62. Hackberry designed its open access FTS rates based on design capacity and did not propose a representative level for allocating costs to ITS service in the calculation of rates. Thus, to the extent that Hackberry renders any ITS service, it must credit 100 percent of the interruptible revenues, net of variable costs, to firm and interruptible customers consistent with Commission policy.[39]

7. Additional Filings

63. In view of the additional support required for Hackberry's pipeline's cost of service and rates, and other changes required to the pro forma tariff, we will require Hackberry to file revised tariff sheets. If Hackberry contemplates making any other changes not specifically authorized by this or a subsequent order in this proceeding prior to placing its facilities into service, Hackberry will need to provide cost data and required exhibits supporting any revised rates under section 7 as part of a request to amend its certificate. After the in-service date, Hackberry may make a filing under section 4 of the Natural Gas Act to change its rates for pipeline service to reflect revised construction and operating costs.

64. Consistent with Commission precedent, we will require Hackberry to make a filing at the end of its first three years of actual operation to justify its existing FTS and ITS rates.[40] In its filing, Hackberry's projected units of service should be no lower than

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[38] KO Transmission Company, 74 FERC ¶ 61,101 (1996).

[39] See, e.g., Independence Pipeline Company, 89 FERC ¶ 61,283 (1999) and Maritimes & Northeast Pipeline L.L.C., 80 FERC ¶ 61,136, at p. 61,475 (1997), order on reh'g, 81 FERC ¶ 61,166, at pp. 61,725-26 (1997).

[40] See, e.g., Trunkline LNG Company, 82 FERC ¶ 61,198, at p. 61,780 (1998), aff'd sub nom., Trunkline LNG Co. v. FERC, 194 F.3d 68 (D.C. Cir 1999); Horizon

(continued...)

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those upon which its approved initial rates are based. The filing must include a cost and revenue study in the form specified in section 154.313 to update cost-of-service data. After reviewing the data, we will determine whether we should exercise our authority under section 5 to establish just and reasonable rates. In the alternative, in lieu of this filing, Hackberry may make a section 4 filing to propose alternative rates to be effective no later than three years after the in-service date for its proposed facilities.

4. Hackberry's Pipeline's Tariff and Related Requests for Waiver of Part 284 Regulations

65. Hackberry's proposed tariff includes Rate Schedules LNG-1, LNG-2, FTS, ITS, and general terms and conditions of service. Given our determination above to authorize the specific service to Hackberry's customer, but not to require Hackberry to offer open access LNG services, those portions of its tariff are no longer necessary. Only pipeline transmission service provisions need to be stated in Hackberry's open access tariff. As a result, Hackberry's open access tariff needs to be revised to reflect this change. Thus, we will require that Hackberry file a revised Part 284 tariff for its pipeline open access services that is in compliance with Order No. 637 and all the orders in the Order No. 587 series.

66. Hackberry also requests "any waivers that may be necessary to provide service under the terms and conditions stated in its pro forma tariff and/or a determination that such terms and conditions constitute reasonable operational conditions pursuant to 18 C.F.R. § 284.7(c)." In its application, Hackberry provides a few examples of areas where its tariff deviated from standard Commission requirements, such as its proposed nomination/confirmation/scheduling procedures, capacity release rules, and use of its pipeline independent of LNG terminalling service. Given our requirement that Hackberry must file a revised tariff, we will not act on Hackberry's requests for waiver of Part 284 of the regulations, as those requests relate to Hackberry's open access transmission tariff, at this time. However, Hackberry must be specific as to which terms it requests waiver for, and must show good cause for each specific request.

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[40](...continued)
Pipeline Company, L.L.C., 92 FERC ¶ 61,205, at p. 61,687 (2000); Vector Pipeline Company, 85 FERC ¶ 61,083 (1998).

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5. Waivers of Accounting and Reporting Requirements

67. Hackberry requests waiver of the accounting and reporting requirements in Part 201 and section 260.3 (Form 2A) of the regulations.

68. Under the requirements of sections 8 and 10 of the Natural Gas Act, all natural gas companies must maintain their books and records and report financial information to the Commission in accordance with prescribed rules and reporting standards. These rules and standards require maintenance of books and records and preparation and filing of financial statements for the entire jurisdictional entity. The entire jurisdictional entity includes all non-utility business activities of that entity, as well as utility functions that are market-based rate regulated. Many of the assets, liabilities, and capital of the reporting entity are applicable on a joint and non-severable basis to all of these business activities. It is not possible to waive the accounting and reporting requirements in Parts 201 and 260 for only part of the operations of a natural gas company. Thus, we will require Hackberry to adhere to these requirements as a condition of the authorization granted here.[41]

IV. Conclusion

69. For the reasons set forth herein, we find, subject to completion of our environmental review and Hackberry's acceptance of the conditions set forth below, that Hackberry's proposed LNG terminal is in the public interest under section 3. Further, the benefits of Hackberry's proposed pipeline will outweigh any potential adverse effects and will be consistent with the Certificate Policy Statement and section 7(c). Thus, we will make a preliminary determination to grant the requested authorizations to Hackberry.

70. At a hearing held on December 18, 2002, the Commission on its own motion received and made a part of the record in this proceeding all evidence, including the application and exhibits thereto, submitted in support of the authorizations sought herein, and upon consideration of the record,

[41] Transok, 97 FERC ¶ 61,362, at p. 62,683 (2001), where we denied a request for waiver of these requirements when the reporting entity has both cost and market based operations included within the same reporting entity.

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The Commission orders:

(A) In Docket No. CP02-378-000, a preliminary determination is made that Hackberry's application under section 3 of the Natural Gas Act to site, construct, and operate an LNG terminal, as described and conditioned herein and as more fully described in the application, would, on the basis of all pertinent non-environmental issues, be consistent with the public interest, subject to the environmental review of the proposal and issuance of a final order.

(B) In Docket No. CP02-374-000, a preliminary determination is made that a certificate of public convenience and necessity under section 7(c) of the Natural Gas Act should be issued to Hackberry authorizing it to construct and operate a 35.4-mile long pipeline, as described and conditioned herein, subject to the environmental review of the proposal and issuance of a final order.

(C) In Docket No. CP02-376-000, a preliminary determination is made that a blanket transportation certificate for transportation of natural gas on the proposed pipeline should be issued to Hackberry under Subpart G of Part 284, subject to the environmental review of the proposal and issuance of a final order.

(D) In Docket No. CP02-377-000, a preliminary determination is made that a blanket construction certificate for the proposed pipeline should be issued to Hackberry under Subpart F of Part 157, subject to the environmental review of the proposal and issuance of a final order.

(E) Any authority granted in the final order in this proceeding with respect to the pipeline shall be conditioned upon Hackberry's compliance with all regulations under the Natural Gas Act including, but not limited to, Parts 154 and 284, and paragraphs (a), (c), (e), and (f) of section 157.20 of the regulations. Hackberry shall not be required to file a tariff for its LNG terminalling service.

(F) Any authority granted in the final order in this proceeding shall be conditioned upon Hackberry's facilities being constructed and made available for service within three years of the date of the final order in this proceeding.

(G) Hackberry's proposed terminalling service for Dynegy Marketing is approved. Prior to the commencement of construction, Hackberry shall file its service agreement with Dynegy Marketing.

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(H) Hackberry's request to use straight-line depreciation and an annual depreciation accrual rate of 3.33 percent for its pipeline facilities is accepted.

(I) Hackberry's proposed capital structure of 70 percent debt and 30 percent equity for its pipeline facilities is accepted.

(J) Hackberry's proposed 13.25 percent rate of return on equity for its pipeline facilities is just and reasonable.

(K) Hackberry shall file tariff sheets 60 days prior to placing the pipeline facilities in service and bring its tariff in compliance with the revisions specified in the body of this order and any future orders issued in this proceeding.

(L) Hackberry shall make a filing within three years after the in-service date of its pipeline facilities, justifying its existing rates or proposing alternative rates, as discussed in this order.

(M) With respect to the pipeline, Hackberry shall comply with the marketing affiliate standards of conduct and reporting requirements of Order No. 497.

(N) Hackberry shall conform its proposed accounting for the pipeline, as described in the body of this order.

(O) All requests for waivers of our regulations and requirements are granted or denied, as discussed in the body of this order.

(P) El Paso Merchant's and BP Energy's untimely motions to intervene are granted.

By the Commission.

(S E A L)

Linwood A. Watson, Jr.,
Deputy Secretary.

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Appendix

Motions to Intervene

BG LNG Services, LLC
BP Energy Company
ChevronTexaco Overseas Petroleum, a division of Chevron U.S.A. Inc.
CITGO Petroleum Corporation
CMS Trunkline LNG Company, LLC
Conoco Inc.
Distrigas of Massachusetts LLC
Exxon Mobil Corporation
Lake Charles Harbor and Terminal District
Nabours, John A.
Project Technical Liaison Associates, Inc.
Shell Na LNG, Inc.
Southern LNG Inc.
Weaver's Cove Energy, LLC